IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 464

GAINESVILLE UTILITIES DEPARTMENT, CITY OF GAINESVILLE, FLORIDA, *Petitioner*,

v.

FLORIDA POWER CORPORATION, *Respondent*

No. 469

FEDERAL POWER COMMISSION, *Petitioner*

v.

FLORIDA POWER CORPORATION, *Respondent*

On Certiorari to the United States Court of Appeals for the Fifth Circuit

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MOTION OF AMERICAN PUBLIC POWER ASSOCIATION FOR LEAVE TO FILE BRIEF AMICUS CURIAE ON THE MERITS, AND BRIEF

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MOTION OF AMERICAN PUBLIC POWER ASSOCIATION FOR LEAVE TO FILE BRIEF AMICUS CURIAE ON THE MERITS

The American Public Power Association respectfully moves this Court for leave to file the accompanying brief on the merits in these cases as *amicus curiae* in support of the position of Gainesville Utilities Department and the City of Gainesville, Florida (No. 464), and in support of the position of the Solicitor

General on behalf of the Federal Power Commission (No. 469). The attorneys for the petitioners have consented to the filing of this brief but the attorneys for the respondent, Florida Power Corporation, have not.

The applicant was granted leave to file a brief as *amicus curiae* in support of Gainesville's petition for certiorari, and did so. The present application is submitted on the same grounds.

American Public Power Association is a national service organization. It has an interest in this case in that it represents more than 1,400 local, publicly owned electric utilities in 48 States, Puerto Rico, the Virgin Islands and Guam. Many of these publicly owned utilities are directly and seriously affected by the decision in the court below.

The basic issue presented in both cases is the terms and conditions which are to prevail for interconnection of facilities between a large and small electric utility pursuant to section 202(b) of the Federal Power Act (16 U.S.C. 824a(b)). The court below adopted a rule of payment between the interconnecting systems which is based upon the benefits which accrue to each, and set aside the Commission's determination that payments should be set according to the responsibilities borne by each system and the costs associated therewith. *Florida Power Corporation* v. *Federal Power Commission,* 425 F.2d 1196 (C.A. 5, 1970).

The decision of the court below presents an important question of federal law which has not been, but should be, settled by this Court. If allowed to stand, without review, the decision will leave in a state of confusion interconnection negotiations under way in many parts of the country at the present time. Fur-

thermore, the decision will seriously impair the prospects for interconnection and coordination between many large and small electric utilities in the future. These are needed to improve service reliability and prevent blackouts, voltage reductions and other disruptions.

Workable interconnections and coordination agreements are an absolute necessity for the survival of many of the dispersed, publicly owned utility systems, which meet an important portion of the Nation's electric energy needs. Many of these systems are members of A.P.P.A. The Association, therefore, respectfully requests this Court to grant it permission to file its annexed brief *amicus curiae*.

Respectfully submitted,

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BRIEF OF THE MERICAN PUBLIC POWER ASSOCIATION AS AMICUS CURIAE, ON THE MERITS

INTEREST OF THIS AMICUS CURIAE

The American Public Power Association is a na-onal service organization representing about 1,400 cal publicly owned power systems in 48 States, uerto Rico, the Virgin Islands and Guam. They nge in size from very large systems, such as the De-rtment of Water and Power of the City of Los ngeles and Seattle City Light, down to the smallest

of publicly owned systems, serving small rural communities. The Association's membership includes municipalities, public utility districts, cooperatives, and other consumer-owned public power systems.[1] Interconnection with the large privately owned power systems which adjoin them is of vital importance to many of the smaller publicly owned utilities. This is not only because of the necessity of obtaining power during emergencies, and during scheduled shut-down of generating equipment for maintenance, but because of the economies of scale which are obtainable by use of the very large generating units which the industry is now installing (some as large as 1 million kilowatts), but which no single small utility can afford. Beyond this, advantages inure to all utilities, large and small, from participation in great multi-system power pools, some of them involving 30 States or more, assuring entire regions against the consequences of local accidents or shortages.[2]

Such interconnections can be compelled by the Federal Power Commission under section 202(b) of the

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[1] The National Power Survey of the Federal Power Commission (1964) reported (p. 267) that of 3,617 systems serving the country (excluding Alaska and Hawaii), 3,190 are "small systems" (defined as systems with peak load requirements of about 25,000 kilowatts or less). Of these, 1,997 were reported as publicly owned, principally by municipalities, and 904 were rural electric cooperatives. 28 percent of the total were reported as generating all or part of their requirements, while 69 percent purchased their entire needs. Of the cooperatives, self-generation, as a proportion of total requirements, was about 18 percent in 1963 (*id.*, p. 270). Among the small municipalities, 742 generated all or part of their requirements in 1962, while 1,130 purchased their entire requirements (*id.*, p. 270). The American Public Power Association states that such later statistics as are available are consistent with these proportions.

[2] This is developed in Part II of the Argument, *infra*.

Federal Power Act (16 U.S.C. sec. 824a(b)). This case arises under that provision of the Act.

This case is of utmost importance to the publicly owned sector of the Nation's power industry, and particularly to the smaller cities and electric cooperatives, because of the extraordinary and wholly novel rationale of the court below in remanding the case to the Commission. The court directed the Commission to redetermine the interconnection compensation due from a small city to a power company some 15 times its size,[3] which, in turn, is a member of a five-utility pool in Florida (App. 354) and is interconnected with power systems in other States (*id.*): namely, that relative disparity in size, of itself, indicates that the benefits of interconnection flow from the larger to the smaller utility, and that this imposes upon the small utility an obligation to pay to the larger a proportion of the benefits that the smaller utility receives from the interconnection (App. 503), in addition to full compensation for all costs of service incurred by the larger utility.

QUESTION PRESENTED

That we are not alone in seeing the foregoing significance in the decision of the court below is shown by the Solicitor General's phrasing of the question on which this Court granted certiorari:

> "Whether the Federal Power Commission, in ordering the interconnection of electric power companies, must condition the interconnection upon compensation terms based on the relative benefits

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[3] In 1965 Gainesville's system had a total capability of 108,400 kw. That of Florida Power Corporation's system had a capability of 1,595,000 kw (App. 354).

> accruing to each utility rather than based upon the relative burdens that each places on the interconnected network."[4]

To this we may add that while the question arises here on a proceeding under section 202(b) to compel an interconnection, the same issue is presented by sections 205 (16 U.S.C. sec. 824d) and 206 (16 U.S.C. sec. 824e), which relate to fixing the rates at wholesale. If the basis of compensation to a large supplier of power is to shift from "cost of service" to "benefits conferred" on the buyer when the smaller purchaser owns generating equipment, is the same new standard to apply if the purchaser owns no generating capacity? Or is the purchaser penalized only if it generates some of the power that it consumes? How is benefit to be measured—by comparison with the next most costly source of power? Is the seller in such cases entitled to cost of service, including reasonable return, plus a profit equal to part of the buyer's savings? Such are some of the unavoidable implications of the decision of the lower court. Manifestly, if the rate to be charged by large utilities to small ones is to be freed from the hitherto accepted criterion of equation with the seller's cost of service, including a reasonable rate of return, and is to be newly equated with the relative benefits accruing to the small purchaser and the large seller, Pandora's box has just been opened by the Fifth Circuit's decision. Neither the Commission nor the courts have held anything like this in the past.

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[4] Petition of the Solicitor General for a writ of certiorari, July 1970, p. 2.

STATEMENT OF THE CASE

The Federal Power Commission's Opinion

The Federal Power Commission, pursuant to section 202(b) of the Federal Power Act (16 U.S.C. sec. 824a(b)), ordered Florida Power Corporation to permit the City of Gainesville, Florida, to interconnect its power system, at Gainesville's expense, with that of the Corporation, on terms stated in the opinion (App. 352) and order (App. 380).

The following extracts from the Commission's opinion explain the transaction. They should be read against the fact which the Court of Appeals later found controlling: the disparity in size between the two (App. 503). Florida Power Corporation is some fifteen times the size of Gainesville's power system, measured in terms of installed generating capacity (App. 354), is a member of a five-utility pool blanketing the State of Florida, and operates in parallel with the Interconnected Systems Group (App. 354),[5] whereas Gainesville owns a completely isolated system (App. 353). The interconnection order was to end this isolation (App. 357). The Commission said (App. 358):

> *"Uses of the Proposed Interconnection*
>
> "All parties agree that the contemplated interconnection would be used initially as follows: for purposes of sharing generating reserves between Florida Power and Gainesville; to facilitate the exchange of hourly non-firm economy energy transfers between the two systems; for weekly or other

[5] The opinion in Cincinnati Gas & Electric Co., et al. v. FPC, 376 F.2d 506 (C.A. 6, 1967), describes the Interconnected Systems Group as consisting of 142 utility systems in 32 States.

short term purchases of electrical capacity and related energy by the Corporation or the City; to permit either system to supply to the other replacement energy during periods of scheduled outage for equipment maintenance purposes; and to meet system electric needs during emergency outages of operating equipment of the City or Florida Power.

"The degree to which these various types of service will be utilized by either party is a matter for decision by personnel of Florida Power and Gainesville. Electrical flows between the systems to complete economy energy transactions, short term sales of electric capacity and related energy, maintenance replacement energy and emergency service will be controlled by the system dispatchers.

"In addition to scheduled transfers between Florida Power and Gainesville, there will be non-scheduled or inadvertent flows through the proposed interconnection. These flows will be instantaneous and occur as generating sources and connected electric loads shift. Depending upon the originating cause they may be in the direction of Florida Power or in the direction of Gainesville.[2] As in the case of scheduled flows, the ultimate limiting factor controlling the magnitude of the inadvertent transfer in either direction is the

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"[2] [FPC footnote] Flows in either direction may reflect occurrences on the Florida Power or Gainesville systems, the systems of other members of the Florida Operating Committee with which the Corporation interconnects, or the systems of utilities operating outside the State of Florida which are electrically connected with Florida Power. Presently, approximately 94 percent of the total installed generating capacity of the Nation's electric utilities is interconnected and operates in electrical synchronism, including members of the Florida Operating Committee."

electrical capacity of the facilities to be installed between the Company and City, 60,000 kva.[3]

(App. 360):

"[3] [FPC footnote] Various briefs of Florida Power denominate these inadvertent transfers as instantaneous emergency service. They are urged as a principal justification for the Corporation's requested 'standby charge' of $3.08/kw up to the capacity of the City's largest generating unit. Gainesville does not seek to apply any such charge against the Company. Florida Power does not assess a similar charge against any other system with which it interconnects, nor does any other member of the Florida Operating Committee. Indeed, the staff's review of pooling agreements and bilateral arrangements between large and small systems described in the record did not reveal any other example of such a charge."

"Uses of System Generating and Transmission Facilities

"Under the terms and conditions of the interconnection as specified in this opinion and order, each system (Florida Power and Gainesville), will be responsible for its own generating capacity and reserve requirements.

"We accept and approve the Examiner's conclusion as to the installed and operating reserves of Gainesville and Florida Power. As expressed in this opinion, we are satisfied that an appropriate basis has been shown for evaluating Gainesville's generating resources and for assigning to the City a reserve responsibility. Briefly, they are those requirements which apply to Florida Power as a member of the Florida Operating Committee, and those which the Corporation applies to itself by reason of its utility operating practices.

"As set forth in finding (7) (a), Gainesville is required to own or secure from others generating capacity equal to or greater than 115 percent of the City's estimated annual peak hour demand. Under finding (7) (c), Gainesville must maintain

ready reserves up to a limit of 15 percent of the City's estimated annual peak hour demand and up to a limit of 10 percent of that demand for spinning reserves. In the light of current reserve practices being followed by Florida Power and other members of the Florida Operating Committee, these requirements will insure that Gainesville discharges its utility service obligations to provide sufficient generating capacity and resources, installed and operating, to supply the needs of its utility consumers.

"Following completion of the proposed interconnection, Gainesville's transmission facilities (principally the 115 kv line to be constructed from the City's existing circuits to the point of interconnection at Florida Power's Archer Substation) will function as a means of interconnecting the City's system with that of Florida Power. Florida Power's transmission network functions, and will continue to function, as a means of interconnecting the Corporation's own generating, purchased power and interchange sources and for delivering power to the Corporation's load centers. After connection, Gainesville will become an additional interchange power source on that network."

(App. 361):

"Compensation

"Gainesville has agreed to absorb the entire cost of the facilities needed for the proposed interconnection. There will be no direct facilities cost to Florida Power. Depending upon final construction plans, the City's capital costs for this purpose will be in the order of $3,000,000.

* * * * *

(App. 361):

"Insofar as the proposed interconnection is used for economy energy, maintenance replacement

energy and emergency service, we adopt the types of compensations (financial payment or return in kind) to Gainesville and Florida Power as set forth in the Examiner's decision and findings (7) (b), (d), (e) and (g) (1) below. The parties do not object to the Examiner's decision in these respects.

* * * * *

(App. 363):

"These charges for services, of which either party may avail itself,[4] will adequately compensate both Florida Power and Gainesville in providing the services. The reserve capacity which we are requiring Gainesville to maintain will assure that Gainesville does not unduly burden Florida Power. The record in this case demonstrates that Gainesville will place no disproportionate burden or reliance on the facilities of the Corporation and thus should not be penalized either in terms of greater reserve capacity requirement than that carried by the other systems in the coordinating area or in terms of a demand charge."

"[4] [FPC footnote] We emphasize that in this particular case neither Florida Power nor Gainesville is being directed to provide any specific firm power service to the other."

In addition, however, Florida Power urged that as the interconnection would save Gainesville $300,000 per year in costs, related to 50,000 kw. of generating capacity which Gainesville would have to maintain as spinning reserve for emergencies if this interconnection were not made, Florida Power should receive compensation in recognition of that benefit (App. 360, n. 3; App. 363). The Presiding Examiner had agreed with Florida Power, and had recommended payment by Gainesville to Florida Power of 50 percent of the saving (App. 363-64). Before the Commission, the

corporation asked approximately the same amount, computing it as $3.08 per kilowatt times 50,000 kilowatts, relating it to fixed charges (App. 360, n. 3; App. 363). The Commission refused, saying (App. 364-65):

> "We agree with Gainesville and with staff that the record in this proceeding does not establish any satisfactory justification for the imposition of a per kw demand charge as requested by Florida Power. We are also of the opinion that the 50-50 split proposal of the Examiner is not appropriate.
>
> "The reasoning of both Florida Power and the Examiner is inconsistent with what we have determined to be the appropriate analysis of the basic issues here presented: sharing the responsibilities of interconnected operations. As we have explained, that sharing must be based upon, and follow, the proportionate burdens each system places upon the interconnected system networks, not the benefits each expects to receive. Benefits received in any given situation may approximate these responsibilities or they may not. In the course of negotiation of voluntary pooling arrangements, benefits received may, on occasion, serve to offset burdens imposed in determining the appropriate charge for particular services rendered or facilities supplied. But where, as here, the cost of providing such services and facilities and the appropriate charges therefor have equitably been determined after a careful analysis and apportionment of the burdens and responsibilities of each party, there is no basis for any further consideration of relative benefits as proposed by the Examiner."

(App. 365):

> "The evidence before us shows that Gainesville will be contributing its proportionate share of in-

stantaneous emergency service and installed generating capacity, including reserve capacity.

"Moreover, the specific type of demand charge requested by Florida Power, namely, the imposition of a charge based upon the size of Gainesville's largest generating unit, would discourage future coordinated planning and operation by reducing the economic incentive for Gainesville to install larger and more efficient generating units. Without such a demand charge, Gainesville could participate more fully in coordinated planning including staggered construction with Florida Power and other systems in Florida to the mutual benefit of all such systems."

It is the decision of the Commission on this issue that brings the case to this Court.

The Commission went on to say (App. 365):

"If we were to appraise Florida Power's request for an annual standby charge in terms of a 'splitting of the benefits' test, this record shows that the proposed intertie will afford both parties opportunities to take advantage of substantial and important benefits: electrical operating benefits and corporate financial savings."

And it developed this point at some length. But, in our view, the question of the ratio of benefits is not relevant to the issue now before the Court, and we do not argue that issue. Our position, stated in more detail later, is that the compensation to which a party to an interconnection is entitled is limited to cost of service, irrespective of the relative benefits of the interconnection to the parties thereto. The court below was mistaken in reading the Commission's order as requiring Florida Power to "bear the allocated fixed cost represented by the added obligation imposed under

the terms of the ordered interconnection." The Commission had said the opposite (App. 363, n. 4):

> "We emphasize that in this particular case neither Florida Power nor Gainesville is being directed to provide any specific firm power service to the other."

And (App. 363):

> ". . . The record in this case demonstrates that Gainesville will place no disproportionate burden or reliance on the facilities of the Corporation and thus should not be penalized either in terms of greater reserve capacity requirement than that carried by the other systems in the coordinating area or in terms of a demand charge."

The Court of Appeals Opinion

The Court of Appeals held that the Federal Power Act conferred power on the Commission to order an interconnection on the application of a municipality, and granted enforcement of that part of the Commission's order. It remanded the case to the Commission "to fix a formula for computing what would be reasonable compensation" to the company, without, however, suggesting a formula to the Commission (425 F.2d 1204). It said, *inter alia* (425 F.2d 1203):

> ". . . the terms of the interconnection do not adequately satisfy the statutory requirements because they do not provide Florida Power with the 'reimbursement reasonably due' it. . . . The interconnection will be of substantial benefit only to the City. Through the interconnection it receives essential emergency back-up, which is a service at all times instantaneously available, and which protects it against the outage of the largest

of its generators. . . . The benefits to Florida Power, however, are largely illusory.

"But, although there is no direct cost, Florida Power, really its customers, will bear a substantial burden. They must bear the allocated fixed cost represented by the added obligation imposed under the terms of the ordered interconnection. And this burden will be reflected in their cost-based rates. They are entitled to not have to carry the entire responsibility for providing an extremely valuable service.

"The Commission's policy of proportionate utility responsibility really works only one way. The small system receives high benefits and, because of its size, no real obligations. The large system, however, receives no benefit but does incur real, substantial responsibilities. Such imaginary equity is not reasonable compensation." (Footnotes and citations omitted.)

SUMMARY OF ARGUMENT

I. Nothing in the Federal Power Act authorizes, much less compels, the Commission to inflate the compensation to a utility for an interconnection, which the Commission finds fully covers its cost of service, by an added allowance for the benefits derived by the other party to the connection, nor to equate such benefits inversely to the size of the participants. The Commission's determination of the service that each participant shall render, and its determinations of the compensation reasonably required to cover the cost of that service, are not subject to judicial displacement, as long (as in this case) as the Commission's order does not require the enlargement of generating or transmission facilities, or compel the exchange of

energy when to do so would impair a utility's ability to render adequate service to its customers, or require the larger utility to bear any of the costs of effectuating the interconnection.

II. The Commission's power under section 202(b) to order interconnections, and to fix the terms and conditions thereof, must be read in the light of section 202(a), which states the criteria which govern all such orders. The purpose stated is that of assuring an abundant supply of electric energy throughout the United States with the greatest possible economy and with regard to the proper utilization and conservation of natural resources. The Commission is directed to promote and encourage such interconnections to effectuate that purpose. The Federal Power Commission's National Power Survey made plain the vital importance to many of the Nation's small publicly owned power systems, both municipals and cooperatives, of interconnection with large regional power pools, in order to obtain the cost advantages of large-scale generating units, and dependability of supply. The lower court's novel interpretation of section 202(b), relating compensation for a large utility's interconnection with a small municipal system to the relative benefits accruing to the two, rather than cost of service, and equating those relative benefits inversely with relative size, would penalize the smaller parties to such arrangements. It would frustrate the policy which the Act declares shall govern the Commission in bringing such interconnections about.

ARGUMENT

I. Under the Federal Power Act, the criterion for compensation to an electric utility is its cost of service, including a reasonable return on the investment, not the benefit derived by the recipient of those services.

1. The company's claim is for phantom services.

At the outset, it should be made clear that the demand of the company is for services which the Commission did not order (the furnishing of firm back-up power), and the compensation that it demands for those uninvited services is for the use of phantom facilities, not required in the services which the Commission in fact ordered.

Florida Power is in error in telling this Court (Brief in Opposition to Gainesville's Petition for Certiorari, p. 10) that the Commission has ordered it to render "emergency backup service" which, according to the company, means:

> "... the furnishing of capacity in a state of readiness capable of supplying instantaneously at any instant of the day or night the energy required to protect against loss of a system's largest generator."

The Commission says that it ordered no such thing. It says (App. 363, n. 4):

> "We emphasize in that particular case neither Florida Power nor Gainesville is being directed to provide any specific firm power service to the other."

In a somewhat similar situation, the Court of Appeals for the First Circuit, in sustaining an FPC decision ordering a privately owned utility to intercon-

nect with a municipality, *New England Power Co.* v. *FPC*, 349 F. 2d 258 (C.A. 1, 1965), rejected the utility's demand that the municipality pay for the use of facilities to provide "back-up protection," saying "NEPCO [the utility] has not been ordered to use those facilities, but merely to provide service to Shrewsbury."

The Commission's expertise certainly extends to perception of the meaning of its own order.[6]

The unspoken but essential premise of the opinion below was that the court was persuaded that the company, rather than the Commission, best understood the Commission's order. We think it vital, as interconnections continue to be ordered by the Commission across the land, that the Commission's expertise to make these distinctions between the various kinds of services it orders should be fully recognized. Cf. *Crisp County Power Comm.* v. *Georgia Power Co.*, 42 F.P.C. 1179 (1969).

There is, of course, an infinite variety in the kinds of service that an interconnection agreement may provide for, and hence in the facilities that may fairly be said to be utilized in performing the agreed services. Such agreements may range all the way from simple exchange of off-peak power to agreements to install generating capacity alternately on the two systems, each committing itself to buy firm power and energy from the

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[6] The Commission's construction of the statute that it is administering is entitled to respect; a fortiori, with respect to the interpretation of its own orders. See *SEC* v. *New England Electric System*, 390 U.S. 207, 211 (1968); *SEC* v. *New England Electric System*, 384 U.S. 176, 185 (1966); *Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *Unemployment Commission* v. *Aragon*, 329 U.S. 143, 153 (1946); *NLRB* v. *Hearst Publications*, 322 U.S. 111, 130-31 (1944).

other in amounts which, in effect, obligate each to share the debt service and other fixed charges on each new unit, even if located on another's system. Manifestly, it is a highly complicated technical problem to determine what investments may fairly be identified with the particular interconnection arrangement under review. This is a problem which calls for the exercise of the expertise of the Commission, not of a court. In this case the Commission, based on its Nation-wide experience with interconnection arrangements, had no difficulty whatever in identifying the arrangement that it was ordering as one of the type which does *not* require the participants to dedicate an investment in generating or transmission facilities to firm power service to the other. Consequently, the Commission properly ruled that Florida Power Corporation was quite out of line in demanding that Gainesville pay it an amount equal to the company's fixed charges (said to be $3.08 per kilowatt) on 50,000 kilowatts of capacity in generating and transmission facilities, as though these facilities were dedicated to Gainesville's exclusive service, day and night, whereas, in fact, the Commission—which ought to know what it was ordering done—found the precise opposite (App. 363, n. 4). The court below failed to grasp this, saying of Gainesville (425 F.2d 1203):

> "... Through the interconnection it receives essential emergency backup, which is a service at all times instantaneously available, and which protects it against the outage of the largest of its generators."

In these circumstances, Florida Power is really demanding payment for a phantom 50,000 kw of dedicated facilities. It seems to wobble between two justifica-

tions for this baksheesh: (1) that it is dedicating an investment on its own system in this amount, (2) that Gainesville, solely because its system is relatively small, is getting a benefit from interconnection with its big neighbor, which it ought to share.

As to the first ground, the phantom requires no nourishment.

As to the second, as we shall see, no utility is entitled to compensation in excess of its cost of service, no matter what benefit the purchaser of those services derives from them.

2. The decision made in this case will control the Commission in its determination of wholesale rates under section 206(a), a responsibility at least as broad as that which it exercises with respect to interconnections under section 202(b).

The Federal Power Commission determines the compensation due an electric utility for its services under two sections of the Federal Power Act, section 202(b) (16 U.S.C. 824a(b)), and section 206(a) (16 U.S.C. 824e(a)).

The standard for determination of compensation under section 202(b) is "compensation or reimbursement reasonably due." Such compensation, in the nature of things, has two elements: (i) the "apportionment of cost" of physically effectuating the interconnection (an issue not litigated here because the Commission allocated the entire cost to the municipality, which is willing to pay these costs), and (ii) the terms of service under which each party shall "sell energy or exchange energy," and the rates and charges for such services, in the functioning of the interconnection after it is physically effectuated.

The second element of the determination is indistinguishable from that which the Commission must make under section 206(a). Section 205(a) requires that all "rates and charges" in connection with "transmission or sale of electric energy" subject to the Commission's jurisdiction "shall be just and reasonable." Section 206(a) authorizes the Commission, on complaint or on its own order, to determine the "just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force."

The Commission's order in a section 202(b) interconnection proceeding, other than the portions describing the physical interconnection to be made, is, for all practical purposes, an application of the same criteria as those which sections 205(a) and 206(a) impose.

As noted below, it is settled that the Federal Power Act requires that compensation to a utility for its services, both under an interconnection agreement reviewed by the Commission pursuant to section 202(b), and under a rate established pursuant to section 206(a), be sufficient, but no more than sufficient, to pay the utility its cost of service, including an allowance for a reasonable return on the investment in the facilities required to supply the services ordered. In neither instance is there authority to increase a rate so founded, in order to recapture a part of the benefit derived by the customer. A decision to the contrary would shatter the Commission's established criteria for the determination of rates at wholesale under section 206(a) as well as its criteria for determination of compensation for interconnections under section 202(b).

We believe it well established that the determination of the elements of compensation, and their amounts,

required to fully compensate a utility for its cost of service, is within the exclusive competence of the Federal Power Commission.[7] When that determination is supported by substantial evidence, it is conclusive. Section 313(b), 16 U.S.C. 825*l* (b). To affirm the lower court's decision would require the breach of this statutory limit on the power of judicial review.

3. The interconnection decisions under section 202(b) give no support to the company's claim for compensation in addition to its cost of service.

Section 202(b), involved here, authorizes the Commission to direct a public utility (if it finds that no undue burden will be placed upon such public utility) to establish physical connection of its transmission facilities with those of one or more other persons engaged in the transmission or sale of electric energy, and to sell energy or exchange energy with such persons. The section goes on to say that the Commission shall have no power to compel the enlargement of generating facilities for such purposes, nor to compel a public utility to sell or exchange energy when to do so would impair its ability to render adequate service to its customers. The Commission is authorized to "prescribe the terms and conditions of the arrangement to be made between the persons affected by any such order, including the apportionment of cost between them and the compensation or reimbursement reasonably due to any of them."

There is no doubt that the Commission's order in this case complies with all facets of this section, except for the controversy about compensation. It has

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[7] *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968); *FPC* v. *Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

found that no undue burden will be placed on Florida Power (App. 357). To assure this, it has required Gainesville to maintain exactly the same margin of reserves on its own system that Florida Power and other members of the Florida Power Pool must maintain on theirs (App. 360, 376). It has required Gainesville to reimburse Florida Power for frequency regulation (App. 362, 378). It has required Gainesville to participate with Florida Power in a coordination committee (App. 362). It has made clear that "in this particular case neither Florida Power nor Gainesville is being directed to provide any specific firm power service to the other" (App. 363, n. 4). Of course, therefore, the Commission is not compelling Florida Power to enlarge its generating facilities for the purpose of this exchange, and is not compelling Florida Power to sell or exchange energy when to do so would impair its ability to render adequate service to its customers. The Commission took special note of these statutory prohibitions, and of its compliance (App. 356-57, 375), and said: "The reserve capacity that we are requiring Gainesville to maintain will assure that Gainesville does not unduly burden Florida Power" (App. 363). As to apportionment of costs of the physical interconnection, Gainesville will bear all of them, of the order of $3,000,000 (App. 361, 368, 375). As to compensation, the Commission sets a schedule of power and energy charges to apply to scheduled flows (App. 376-78), and no one complains of it. As to non-scheduled or inadvertent flows (which is all there is left to argue about), the Commission says that "These flows will be instantaneous and occur as generating sources and connected electric loads shift. Depending upon the originating cause they may be in the direction of Florida Power or in the direction of

Gainesville" (App. 359), and the Commission sets rates for payment for the power and energy so flowing (App. 377-78).

The sole question, therefore, is whether these rates, set by the Commission, which fully recover cost of service (App. 363), including a reasonable return on the investment, should be inflated to include an added charge to reflect the benefit that Gainesville will derive, as an interconnected utility, from the consequence of not needing to invest as much money in reserve generating capacity as it would be required to do if it continued to operate in isolation.

On this, the Commission correctly says (App. 360, n. 3), "Florida Power does not assess a similar charge against any other system with which it interconnects, nor does any other member of the Florida Operating Committee. Indeed, the staff's review of pooling agreements and bilateral arrangements between large and small systems described in the record did not reveal any other example of such a charge." [8]

In short, there is no precedent, in any section 202 interconnection proceeding, for the novel "sharing of benefits" criterion of rate-making proposed here, and nothing in the Act suggests such a criterion.

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[8] The notion that a smaller party to an interconnection should pay the larger for a "benefit" in addition to compensation for cost of service apparently did not occur to Florida Power Corporation when it joined the Florida Power Pool. In that pool, it has a much larger partner, Florida Power and Light Company. According to the Federal Power Commission in "Statistics of Privately Owned Electric Utilities in the United States for the year ended Dec. 31, 1968," p. 603, Florida Power and Light Company's installed capacity is about 2½ times that of Florida Power Corporation: 4,331,940 kw compared to 1,669,400 kw. But no "standby" charges are paid by Florida Power Corporation.

To the contrary, where, as here, the interconnection arrangement does not require either party to maintain reserve capacity for the accommodation of the other, the practice of the industry, and that of the FPC, is not to assess interconnection charges for a non-existent burden. See *Crisp County Power Commission* v. *Georgia Power Company*, 42 F.P.C. 1179, 1189, 1195-96 (1969).

In *New England Power Co.* v. *FPC*, 349 F. 2d 258 (C.A. 1, 1965), in ordering an interconnection between a private utility and a municipality, the Commission rejected the company's demand for compensation for facilities not required to be used in providing the service ordered (a situation analogous to the one before the Court), and, impliedly at least, equated compensation with cost of the ordered service.

In *South Carolina Generating Co.*, 16 F.P.C. 52 (1956), a utility asked approval of a rate contract with another utility for the sale of a portion of its generating capacity where the charge exceeded the costs by one-half of the difference between the seller's costs and those which the purchaser would have incurred if it had constructed its own plant. This proposal bears a family resemblance to Florida Power Corporation's proposal here. The Commission reduced the proposed charge. It held that the reasonableness of the rate should be determined by cost of service, not by the value of service to the purchaser. It added that a value of service rate would be a "radical departure from established ratemaking principles utilized by this Commission in the regulation of public utility rates in the electric industry where there is a clearly ascertainable cost of service." 16 F.P.C. 52, 57.

The Commission added (pp. 57-58):

> "... We wish to make it expressly clear that our decision is based upon a rejection of the applica-

tion of the value-of-service formula to the rate for the sale of electric energy to Georgia Power Co. Of course, we are not bound to use one formula in our determination. We have heretofore consistently found, with court approval, that the cost-of-service formula is the one best adapted in determining just and reasonable rates in this industry where all costs are known or clearly determinable.

"The value-of-service approach advocated by Generating Co. would result in a chaotic structure based in part upon the cost to the buyer of supplying substitute power. Such 'regulation' would, in fact, be no regulation at all and would completely disregard the public interest and the ultimate consumer which the act is designed to protect. *Cf. Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 672. *Mississippi River Fuel Corp.* v. *Federal Power Commission,* 121 F. 2d 159 (C. A. 8, 1941)."

On review, the Court of Appeals in *South Carolina Generating Co.* v. *FPC,* 249 F. 2d 755 (C.A. 4, 1957), remanded the case to the Commission on other grounds. But it affirmed the Commission's rejection of the value of service standard in fixing rates. The court said that the Commission was justified in lowering the rate and fixing a new rate based on the cost of service in accordance with the orthodox methods of rate-making in utility cases. 249 F. 2d 755, 759-62.

In *Public Service Co. of Oklahoma,* 25 F.P.C. 656, 662 (1961), the Commission disapproved an Examiner's "value of service" concept of rate-making, saying:

"... We disapproved such a 'what the traffic will bear' theory in *South Carolina Generating Co.* (Opinion No. 297), 16 F.P.C. 52 (1956)."

The Commission approved rates which, it said,

"... will not produce revenues in excess of Company's cost-of-service including an allowance of no

more than a fair return on its net investment in facilities used to provide the services and are therefore just and reasonable." (p. 662.)

4. The wholesale rate cases lend the company no support.

As we have noted, section 205(a) of the Federal Power Act requires that all rates and charges by any public utility in connection with the transmission or sale of electric energy shall be "just and reasonable." Section 206(a) authorizes the Commission, after a hearing, and upon its own motion or upon complaint, to find (among other things) that any rate, charge or classification is unreasonable, and to "determine the just and reasonable rate, charge, classification, rule, regulation, practice or contract to be thereafter observed and in force. . . ."

In the administration of those sections, the Commission's decisions, and those of the reviewing courts, have uniformly and exclusively restricted rates to a level not exceeding cost of service, including, of course (as here), a reasonable return on the investment.

See *South Carolina Generating Co.* v. *FPC,* 261 F. 2d 915 (C.A. 4, 1958); *Safe Harbor Water Power Corp.* v. *FPC,* 179 F. 2d 179 (C.A. 3, 1949), *cert. denied* 339 U.S. 957 (1950); *Georgia Power Co.* v. *FPC,* 373 F. 2d 485 (C.A. 5, 1967); *Otter Tail Power Co.* v. *FPC, et al.,* 429 F. 2d 232 (C.A. 8, 1970).

Indeed, still lower rates have been sustained when established by contract. *FPC* v. *Sierra Pacific Power Co.,* 350 U.S. 348 (1956); *St. Michaels Utility Comm.* v. *FPC,* 377 F. 2d 912 (C.A. 4, 1967).

If, as seems clear, the cost of service criterion sets a ceiling on rates when the larger utility is selling

power to a smaller one which owns no generating capacity whatever (this is the typical section 206(a) case), why should the smaller one be penalized if, and only because, it owns generating equipment? The court below seemed to recognize this, but missed its significance. It said, in response to a jurisdictional objection of the company, that, after examining the legislative history, " . . . we can find no support for the conclusion that municipalities which generate their own power were to be treated differently from non-generating municipalities concerning anything other than 'wheeling'." 425 F. 2d at 1202-03 (App. 501). If this is true with respect to the Commission's jurisdiction, strong evidence would be needed to show that different substantive treatment of the two classes of municipalities was intended by Congress with respect to the criteria controlling the bills that they must pay for power services. There is none.

5. The natural gas rate cases are in conflict with the opinion below.

Both sides in this controversy refer to decisions of the Commission and the courts in cases involving the determination, under the Natural Gas Act (15 U.S.C. 717, et seq.) of rates charged by producers of natural gas. That Act and the Federal Power Act contain parallel provisions with respect to rate standards.[9] There are, of course, notable differences in the problems presented in the regulation of rates in the gas and electric industries. For example, the life of a

[9] Compare section 205 of the Federal Power Act (16 U.S.C. 824d) with section 4 of the Natural Gas Act (15 U.S.C. 717c), and section 206(a) of the Federal Power Act (16 U.S.C. 824e(a)) with section 5 of the Natural Gas Act (15 U.S.C. 717d(a)). The two Acts are frequently construed in parallel.

natural gas field may be assumed to be 20 years or less; the producer is not assured a monopoly; he can withdraw from service; his is a high-risk venture which, it is argued, must offer extraordinary inducements to the investor, and his industry is in competition with other sources of fuel, the costs of which fluctuate. Yet, despite these differences, it is notable that the Commission and the courts, in passing on the propriety of prices for natural gas, have been most reluctant to stray from the guide line of the seller's costs plus a reasonable return on his investment, and in no case, so far as we have discovered, has any decision sanctioned the fixing of gas prices on the basis of benefit to the consumer, rather than cost of the seller's services. The "interest of the consumer," and his right to "just and reasonable rates," appear dominant. Cf. *UGI* v. *Callery Properties,* 382 U.S. 223 (1965); *FPC* v. *Sunray DX Oil Co., et al.,* 391 U.S. 9 (1968). The cases recognize that the Commission must examine the seller's cost of service because the purchaser, who can pass costs along to the consumer, lacks "sufficient incentive to bargain prices down" (391 U.S. at 25-26). The "in line" price range has been related to "determined costs," plus a rate of return deemed high enough to constitute the necessary inducement. See *Bel Oil Corp.* v. *FPC,* 255 F. 2d 548 (C.A. 5, 1958), *cert. denied* 358 U.S. 804 (1958); *City of Detroit* v. *FPC,* 230 F. 2d 810 (C.A. D.C., 1955); *Forest Oil Corp.* v. *FPC,* 263 F. 2d 622 (C.A. 5, 1959); *Atlantic Refining Co.* v. *PSC of New York,* 360 U.S. 378 (1959); *UGI* v. *FPC,* 283 F. 2d 817 (C.A. 9, 1960); *PSC of New York* v. *FPC,* 287 F. 2d 146 (C.A. D.C., 1960); *UGI* v. *FPC,* 287 F. 2d 159 (C.A. 10, 1961); *UGI* v. *FPC,* 290 F. 2d 133 (C.A. 5, 1961), *cert. denied* 368 U.S. 823 (1961). See also *Area Rate Proceedings (Southern Louisiana*

Area), F.P.C. Opinion 546, 40 F.P.C. 530, 636, et seq. (1968).

In *Natural Gas Pipeline Co.* v. *FPC,* 120 F.2d 625 (C.A. 7, 1941), the Commission had fixed a gas price related to cost of service. It refused to include in the rate base an item for going value. It also rejected the company's contention that the price should be determined by the market. The Court of Appeals remanded, with directions to include going concern value in the rate base. But with respect to the company's contention that "reasonableness of rates is determined 'not by what profit it is reasonable to make, but what is reasonable to charge for the services rendered'," the court said (p. 633):

> "We reject, without extended discussion, the contentions (a) and (b). They ignore the well-established holdings, backed by reason and experience, to the effect that a fair rate of return, on a fairly established rate base, supplies the correct test of reasonableness. The value of the service to users is neither a reasonable rule, nor supported by judicial decisions.
>
> "This seems too elementary to require elaboration or supporting argument."

The Supreme Court (315 U.S. 575 (1942)) reversed the holding that going value must be included in the rate base (sustaining the Commission on this issue), but did not disturb the holding of the court (and Commission) with respect to "value of the service to users."

In *Mississippi River Fuel Corporation* v. *FPC,* 121 F.2d 159, 164 (C.A. 8, 1941), the court, in sustaining an order of the Commission in a gas price case,

said: " . . . The value of the service to users is neither a reasonable rule nor supported by judicial decisions."

Inasmuch as the parallel provisions of the Federal Power Act and the Natural Gas Act, in the past, have been subject to the same rules of construction, a new interpretation of the terms "compensation or reimbursement reasonably due," in section 202(b) of the Federal Power Act, equated with "just and reasonable" rates and charges in section 205(a) of that Act, as meaning the seller's cost of service (including reasonable return on his investment) *plus* half of the buyer's benefit, would create an intolerable dichotomy with the adjudicated meaning of the same words "just and reasonable" in section 4 of the Natural Gas Act (15 U.S.C. 717c).

II. The statutory purpose of "assuring an abundant supply of electric energy throughout the United States with the greatest possible economy with regard to the proper utilization and conservation of natural resources," by means of interconnections, would be paralyzed if the consumers served by small utilities were penalized as the company proposes in this case.

The purpose stated by section 202(a) is that of assuring an abundant supply of electric energy throughout the United States with the greatest possible economy and with regard to the proper utilization and conservation of natural resources. The Commission is directed to promote and encourage such interconnections to effectuate that purpose. The Federal Power Commission's National Power Survey (1964) made plain the vital importance to many of the Nation's small consumer owned power systems, both municipals and

cooperatives, of interconnection with large regional power pools, in order to obtain the cost advantages of large-scale generating units, and dependability of supply. The lower court's novel interpretation of section 202(b), relating compensation for a large utility's interconnection with a small municipal system to the relative benefits accruing to the two, rather than cost of service, and equating those relative benefits inversely with relative size, would penalize the smaller parties to such arrangements.

On the rationale of the court below, (1) an isolated utility which becomes a member of a power pool, particularly a small utility, always has greater need for the interconnection than the pool has need for the newcomer's relatively small generating capacity; (2) the benefits in terms of immediate savings resulting from the interconnection are therefore larger to the newcomer than to the pool members; (3) the newcomer must, therefore, always owe a share of these savings to the pool as economic rent, "economic penalties for being the last one on the interconnected network" as the Commission called it in rejecting this conclusion (App. 358).

As the FPC said in *Crisp County Power Commission* v. *Georgia Power Company*, 42 F.P.C. 1179, 1187 (1960):

> "... The ever-widening gap that technology has created between large interconnected systems and isolated systems, in the economical use of capital and the efficient production of energy, threatens the survival of many small systems. Unless isolated systems can enter into coordination agreements with their larger interconnected neighbors, their outlook appears bleak, indeed."

Their outlook will be bleaker still if the ruling below becomes law.

As the Commission pointed out (App. 365):

> "... the specific type of demand charge requested by Florida Power, namely, the imposition of a charge based upon the size of Gainesville's largest generating unit, would discourage future coordinated planning and operation by reducing the economic incentive for Gainesville to install larger and more efficient generating units."

The same would be true no matter how artfully the "economic penalty" might be phrased. What is at stake here is not the validity of the particular type of economic penalty demanded, but the lawfulness of *any* scheme which would enable a seller of electricity, compensated for all of its cost of service, to pad its charges by an amount equal to a share of the benefits received from those services by the buyer thereof. On this, the Commission was right, as a matter of law as well as of policy, and the lower court was wrong on both.

The predicament of the small power systems of the United States was eloquently stated in the National Power Survey of the Federal Power Commission in 1964. The Commission said (p. 267):

> "The small systems[10] in the electric power industry are understandably concerned about their future welfare as elements of the complex industry structure which serves America's electric consum-

[10] Our footnote. The Commission defined "small systems" as those having annual energy production requirements of less than 100 million kilowatt hours, which, at an assumed annual load factor of 45 percent, it equated with peak load requirements of 25,000 kilowatts or less (p. 267).

ers. They fear that the growing emphasis on the economies of scale in generation and transmission will reduce their opportunities for the orderly expansion of their own generating capacity, and perhaps even threaten their survival.

"The interests of the small systems are a matter of vital concern in this National Power Survey. Small systems must recognize the need for obtaining their power supply from low cost sources and there must be opportunity for them to do so. Participation of the small systems in the benefits of coordination and a continuous search for means of broadening this participation are fundamental if these systems are to continue to provide low cost power to their consumers and make the most efficient use of our fuel and capital resources. Reduction in the costs of generation of the larger systems through more extensive adoption of the concepts discussed in the Survey can and must provide attractive sources of power for the use of the small systems, rather than serve as a threat to their existence."

Not long after that report (1964), the Northeast Blackout (1966) added emphasis, if any was needed, to the wisdom of the policy of integration declared 30 years earlier in section 202(a) of the Federal Power Act. The industry and the Commission have moved mightily in the last few years to carry out that policy. As the Commission said in the instant case (App. 359, n. 2), some 94 percent of the total installed generating capacity of the Nation's electric utilities is interconnected and operates in electric synchronism.

But the Nation's smaller publicly owned systems and cooperatives, not yet interconnected with the giant systems which adjoin them, are at an economic disadvantage, because of the enormous strides which

the industry has made in reducing costs by installation of larger generating units, too large and expensive for a small municipality to afford.

The Federal Power Commission reports[11] that at the end of 1968 there were 140 fossil-fueled plants of 500,000 kw and larger in service in the United States, the largest of which had the unprecedented capacity of 2,175,000 kw. 151 new fossil-fueled units of 300,000 kilowatts or larger, with a total capacity of 88,000,000 kilowatts (equal to more than 40 Hoover Dams) are scheduled for operation between 1969 and 1975. Seven-eighths of this capacity will be in units of 500,000 kilowatts or larger. This trend toward greater size is dramatically illustrated by comparison of statistics for 1948 and 1968.[12] In 1948, the 53 new units reported averaged 41,000 kilowatts each. In 1968, the 43 new units reported averaged 414,000 kilowatts each. All of these figures are in addition to the statistics for nuclear-powered plants.[13] These include 80 units in 58 plants that are expected to go into operation between 1969 and 1977, varying in size between 450,000 and 1,175,000 kilowatts each.

The effect of increase in size is a dramatic reduction in costs per kilowatt of capacity, and per kilowatt hour of energy.

The National Power Survey of the Federal Power Commission (1964) stated, as a feasible target, that a reduction can be expected in the Nation-wide aver-

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[11] FPC, Steam-Electric Plant Construction Costs and Annual Production Expenses, Twenty-first Annual Supplement, 1968, p. x.

[12] *Id.*, p. ix.

[13] *Id.*

age price per kilowatt hour from about 1.7 cents in 1963 to about 1.2 cents in 1980, a reduction of 27 percent (p. 277). But these are averages. They do not disclose the disparity between the high costs incurred by a small municipality or cooperative generating power with units of, say, 10,000 kilowatts of capacity each (Gainesville's largest is 50,000), and those incurred by a utility able to afford new generating plants with units of 500,000 kilowatts each.

The Federal Power Commission's National Power Survey showed an acute awareness of this, and of the necessity for effective enforcement of the interconnection authority of section 202(b) to bring the benefits of low-cost power to the consumers served by small utilities (p. 274). That report's discussion of the predicament of small power systems ended on a note which we think can appropriately bring this argument to its close (p. 275):

> "Psychological barriers also stand in the way of full coordination between the small municipal and cooperative systems and the investor-owned systems. These barriers are the fruit of decades of intra-industry animosities, and they impair many opportunities for small system improvement. Because of their distrust the municipalities and cooperatives are often hesitant to sacrifice any of their autonomy by purchasing power from investor-owned systems or engaging in joint projects with them regardless of the prospect of large economies.
>
> "Overcoming these barriers is an important goal for the entire industry, but it will not be easy to attain. Determined and resourceful leadership in all branches of the industry will be required. The Federal Power Commission is attempting to contribute to the elimination of these obstacles by

the effective and impartial regulation of wholesale electric rates and the terms and conditions of service for transactions in interstate commerce.

"Where economic strength alone determines bargaining power, the small systems may be at a great disadvantage, but where regulation is effective, long-term wholesale relationships can be built firmly on a foundation of legally-enforced rights and responsibilities. With such a foundation the parties are enabled to reach the most economic solution to the problem of power supply under the particular circumstances of each case."

CONCLUSION

The judgment of the Court of Appeals should be reversed, and the case remanded to that court with instructions to affirm the opinion and order of the Federal Power Commission.

Respectfully submitted,

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December 24, 1970